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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

FREDRIC HABERMAN, *et al.*,
Appellants,

vs.

WASHINGTON PUBLIC POWER SUPPLY SYSTEM, *et al.*,
Appellees.

On Appeal From the Supreme Court of Washington

BRIEF IN OPPOSITION TO MOTIONS TO DISMISS AND/OR AFFIRM

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STATEMENT PURSUANT TO RULE 28.1

The statement required pursuant to Rule 28.1 is found in an attachment to the jurisdictional statement of appellants Fredric Haberman, *et al.*

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I. Restatement of the Case

Appellees have visited upon this Court three separate briefs in which they move for dismissal of plaintiffs' appeal.[1] All three briefs advance the lack of finality doctrine as a bar to constitutional review. In addition, WPPSS, 22 of its members, and most of the professional defendants, seek an order affirming the decision of the court below. They argue that elimination by retroactive state legislative fiat of plaintiffs' property right to statutory causes of action for viola-

[1]Separate briefs have been filed on behalf of WPPSS and other defendants including the City of Ellenburg ("Ellenburg Br."), the City of Seattle ("Seattle Br."), and the Columbia Appellees ("Columbia Br.") representing 17 of the 68 non-member participants. The term "WPPSS," as well as other shorthand designations used in this brief, are defined in plaintiffs' jurisdictional statement.

tion of the Washington Blue Sky Law during the pendency of this suit does not violate the Contracts Clause, U.S. Const. Art. I, § 10, cl. 1.

Appellees' briefs contain numerous misstatements. Perhaps most egregious is the contention that, prior to 1980, a violation of RCW 21.20.430(1) required proof of scienter. This contention has been forcefully rebutted by Appellants Amexco/U.S. *See* Amexco/U.S. Brief in Opposition at 4-5. The truth is that prior to the retroactive enactment of the Scienter Amendment, investors victimized by Washington State municipalities and their agents because of prospectus fraud[2] had a property right in a strict liability cause of action for innocent misrepresentation or breach of warranty under RCW 21.20.430(1) similar to that available for a violation of Section 12 of the 1933 Act, 15 U.S.C. § 77l. *See Haberman v. WPPSS*, 107 Wash.2d 107, 749 P.2d 1032, 1048-1050 (1987).

Appellees also indulge in speculative innuendo on motives. They contend that, as members of the WSSA class in related federal litigation known as MDL-551, plaintiffs and Amexco/U.S. prosecute this appeal in an attempt to "split and manipulate the issues." Columbia Br. at 10. To be sure, appellants did not raise a federal constitutional challenge to the Washington State Supreme Court's ruling on the separation of powers doctrine. This is becauase application of this doctrine to the Scienter Amendment is a question of state constitutional law, not because of any hidden agenda. *See* Amexco/U.S. Brief in Opposition at 3, n. 4.

The recent July 14, 1988 ruling of the federal court reversing previous decisions in favor of the WSSA class on the separation of

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[2]The court below found that official statements and annual reports issued by WPPSS were subject to WSSA prohibitions against prospectus fraud. *Haberman*, 749 P.2d at 1052. More recently, the same court held in *Hoffer v. State of Washington*, 110 Wash.2d 415, 755 P.2d 781 (1988) that opinion letters of the Washington State Auditor included in WPPSS annual reports and on WPPSS 4/5 bond certificates themselves contained representations actionable under the Washington Blue Sky Law. Proof under a scienter standard of the WSSA claims raised in *Hoffer*, of course, patently will prolong that litigation. *Hoffer*, 755 P.2d at 783, 789-790.

powers doctrine and holding the Scienter Amendment constitutional cited by appellees, Columbia Br. at 6-7, adds to rather than detracts from the urgency of this appeal. Immediate review of the constitutional questions presented by plaintiffs and Amexco/U.S. patently will benefit all WPPSS 4/5 bond litigations — those in federal as well as state court — *either* by deciding WPPSS 4/5 bond purchasers have a property right to a strict liability cause of action under WSSA making possible summary disposition of this case, Plaintiffs' Jurisdictional Statement at 4, 8, *or* that the Scienter Amendment requires proof of deliberate fraudulent conduct by WPPSS to establish a WSSA violation. No matter how decided, judicial economy and the interests of WPPSS 4/5 bond purchasers in limiting litigation costs will be served by this appeal.[3]

II. Application of the Cox Broadcasting Criteria Calls for Immediate Review Under the Finality of Judgment Doctrine

Appellees correctly assert that plaintiffs rely in their jurisdictional statement on two prongs of the four-part test enunciated in *Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469 (1975) for determining whether immediate review of a final judgment on an important federal issue is appropriate under 28 U.S.C. § 1257(2).

As an initial matter, plaintiffs argue this case fits within the second criterion because the question whether retroactive application

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[3]A June 15, 1988 article entitled "Donovan, Cravath Get Share of $95 Million WPPSS Fees", *New York Law Journal*, Vol. 199, No. 114 at 1, dramatically illustrates the legal expense generated by the complexity of the fraud action in MDL-551 under SEC Rule 10b-5, 17 C.F.R. 240.10b-5. Legal fees and expenses paid by Chemical Bank, the bond trustee for WPPSS 4/5 bonds, totaled $76 million through the end of 1987. The same article goes on to state that "WPPSS records show the bank expects to pay $24 million more to [four law firms] by the year's end." The $76 million excludes fees and expenses to be sought by the class action plaintiffs in MDL-551 out of negotiated settlements, leading the article's writer to comment: "Some lawyers involved in the WPPSS case joked that costs may exceed any settlement or jury award brought [sic] by bondholders...."

of the Scienter Amendment is constitutional "will survive and require decision regardless of the outcome of further state-court proceedings." *Cox Broadcasting*, 420 U.S. at 480. Appellees' ingenuous response is that plaintiffs "would have no basis to challenge the Scienter Amendment if they were to prevail at trial using the higher standard of proof required by that legislation." Ellenberg Br. at 11. This response utterly fails to take into account appeals subsequent to trial.

Even assuming plaintiffs prevail in proving WPPSS and its agents violated RCW 21.20.430(1) utilizing scienter rather than strict liability standards, appellees certainly will appeal. Plaintiffs then will be forced to raise on cross-appeal the same constitutional issues now before this Court to preserve them for further appellate review. *See Pennsylvania v. Richie*, 94 L.Ed.2d 40, 52, n. 7 (1987) (the goals of finality are frustrated, rather than furthered, by "wasteful and time consuming procedures" requiring an appellant to fruitlessly raise constitutional issues in a new set of appeals.) If the requirement of finality is to be given a "practical rather than a technical construction," *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541, 546 (1949), this appeal surely falls within the second category of the *Cox Broadcasting* criteria.

Plaintiffs also assert the fourth *Cox Broadcasting* criterion allowing for immediate review where, as here, "reversal of the state court on the federal issue would be preclusive of any further litigation on the relevant cause of action," and "refusal immediately to review the state court decision might seriously erode federal policy." 420 U.S. at 482-483. In their response, appellees misread what this Court meant by the term "relevant cause of action," Ellenburg Br. 12-13, and denigrate the importance of federal constitutional policy prohibiting impairment of contracts by state legislatures. Ellenburg Br. at 13-15.

First, the relevant cause of action presented by this appeal is not, as contended by appellees, the standard of culpability to obtain rescission of a securities transaction under WSSA. Ellenburg Br. at 13. The phrase "relevant cause of action" in *Cox Broadcasting* refers to the federal issue which the state court has finally determined, not

the case itself. 420 U.S. at 483. Here, the federal issue is whether retroactive passage of the Scienter Amendment eliminates plaintiffs' property right to strict liability causes of action for innocent misrepresentation and breach of warranty under RCW 21.20.430(1).

Causes of action constitute a species of property protected by the Constitution. *Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 428 (1982).[4] When the requirement to prove fraud is added to a state blue sky law, a quasi-contract or warranty cause of action is transmogrified into a tort claim. *Mary Pickford Co. v. Bayly Bros.*, 12 Cal.2d 501, 56 P.2d 102, 110-111 (1939). Before enactment of the Scienter Amendment, a "seller" of securities was strictly liable under the Washington Blue Sky Law for a violation of RCW 21.20.430(1). This was so even if he innocently misrepresented a material fact in a prospectus or negligently engaged in a course of conduct in connection with offers and sales of securities that operated as a fraud on investors. *See* Plaintiffs' Jurisdictional Statement at 14-15; Amexco/U.S. Brief in Opposition at 4-5. A determination by this Court that the Contracts Clause prohibits retroactive elimination of plaintiffs' strict liability action under WSSA is clearly preclusive of further litigation on the relevant cause of action raised by this appeal.

Second, it is equally clear that when state legislators enact laws that impair contracts, especially contracts of political subdivisions of the state which primarily impact on non-resident investors,[5] an important federal policy is seriously undermined. The prohibition against states enacting laws to impair contracts is found in Article I of the Constitution together with prohibitions against enactment of bills of attainder, *ex post facto* laws, and the grant of titles of nobili-

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[4]The WSSA strict liability cause of action eliminated by retroactive application of the Scienter Amendment is akin to that provided by Section 12(1) of the 1933 Act. *Cf. Pinter v. Dahl*, 100 L.Ed 2d 658, 676 (1988). ("The registration requirements are the heart of the [1933] Act, and Section 12(1) imposes strict liability for violation of these requirements.")

[5]That the bond indenture is a contract with plaintiffs cannot be gainsaid: "WPPSS contracted with the bondholders, received their money and appropriated it for its purposes." *Chemical Bank v. WPPSS*, 102 Wash.2d 875, 691 P.2d 524, 545 (1984), *cert. denied*, 471 U.S. 1065 (1985).

ty. The force of the Contracts Clause remains with us. "It is not a dead letter." *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 241 (1978). "[T]he Framers placed a [high value] on the protection of private contracts. Contracts enable individuals to order their personal and business affairs. . . Once arranged, those rights and obligations are binding under the law, and the parties are entitled to rely on them." *Id.* 488 U.S. at 245.

The decision in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), cited in all three appellees' briefs as authority for dismissing this appeal, in fact strongly supports plaintiffs' case for immediate review. The question posed in *Southland* was whether the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, preempted legal remedies available under a state franchise investment law. The appellant who sought review under 28 U.S.C. § 1257(2) could have prevailed at trial in the state courts. However, this Court held that failure to grant immediate review left in effect a decision of the California State Supreme Court holding that a state franchise investment law can be read to bar arbitration under federal law, a potentially serious erosion of federal policy:

> Plainly the effect of the judgment of the California court is to nullify a valid contract made by private parties under which they agreed to submit all contract disputes to final, binding arbitration. . .
>
> Contracts to arbitrate are not to be avoided by allowing one party to ignore the contract and resort to the courts. Such a course could lead to prolonged litigation. . .

Southland, 465 U.S. at 7.

Here we are presented with parallel circumstances. Failure to grant immediate review would leave in effect a decision of the Washington State Supreme Court that passage of the Scienter Amendment nullifies an obligation of a Washington State issuer to be bound by a strict liability cause of action enacted to avoid prolonged litigation by victimized investors. Similar to the case in *Southland*, the important federal policy embodied in the Contracts Clause prohibiting state legislation that retroactively impairs contracts would be seriously undermined if immediate review is not granted.

III. Whether Enactment of the Scienter Amendment Violates the Contracts Clause Raises a Substantial Federal Question

The Ellenburg appellees contend that the Contracts Clause challenge to the retroactive application of the Scienter Amendment does not present a substantial constitutional question because plaintiffs seek to enforce a contractual right to a statutory cause of action. Ellenburg Br. at 16-20. But the Washington State Supreme Court had no difficulty recognizing the merits of this constitutional claim. The court below initially acknowledged the rule that "[i]n situations where statutes govern the interpretation and enforcement of private agreements, such statutes may create contractual rights . . ." *Haberman*, 749 P.2d at 1059. *See* Plaintiffs' Jurisdictional Statement at 11-12, 15-16.

Plaintiffs' appeal, however, does not rely solely on generally accepted rules of contract intepretation. It is firmly grounded on explicit language of a contract binding on sellers of WPPSS 4/5 bonds, specifically Section 14.1 of WPPSS Resolution 890. Prefaced with the caption, "Resolution and Laws a Contract with Bondholders," Section 14.1 declares: "*In consideration of the purchase* and acceptance *of the Bonds by those who shall hold the same from time to time*, the provisions of [Resolution 890 and the laws of the State of Washington] shall constitute a contract with the holder or holders of each Bond. . . and the obligations of the [Supply] System and the [WPPSS] Board under said laws and under the Resolution shall be enforceable by any court of competent jurisdiction." (Emphasis added.) Plaintiffs' Appendix at 129.

It has long been held that the laws of a state which subsist at the time a contract is made enter into and become part of the contract. *Von Hoffman v. Quincy*, 4 Wall 535, 550 (1867). *Accord, Home Building & Loan Association v. Blaisdell*, 290 U.S. 398, 429-430 (1934). By expressly incorporating this principle of law in Section 14.1, WPPSS promised that the laws of the State of Washington existing at the time investors purchased WPPSS 4/5 bonds were deemed part of the remedies available to enforce rights arising out

of the securities transaction. There can be no other fair construction of language stating that the laws of the State of Washington "shall constitute a contract" in consideration of the purchase of WPPSS 4/5 bonds "by those who shall hold the same from time to time." This construction is not only consistent with precedent, it fully comports with the language of RCW 21.20.430(1). This statute declares an investor complaining of prospectus fraud "may sue either at law or in equity to recover the *consideration* paid for the security." (Emphasis added.)

Implicitly acknowledging the validity of plaintiffs' impairment of contracts argument, appellees alternatively resort to a most curious, strained interpretation of Section 14.1. They ask this Court to read that provision of the bond indenture as an agreement by WPPSS 4/5 bond purchasers that the laws of the State of Washington could be amended and supplemented willy-nilly to eliminate property rights to statutory causes of action for prospectus fraud.

The Ellenburg appellees state their remarkable case as follows: "[T]he fact of the matter is that the Bond Resolution envisions and adopts state law 'as amended and supplemented.' In short, the Bond Resolution contemplates amendments to state law. . ." Ellenburg Br. at 18. This argument distorts the ordinary manner of contract draftsmen. What Section 14.1 does say is that the bond indenture is adopted "under the authority of and in full compliance with the Constitution and the laws of the State of Washington, including Titles 43 and 54 of the Revised Code of Washington, as amended and supplemented." Plaintiffs' Appendix at 129. There is no other accepted way of identifying the laws that have been amended at the time a contract is formed. Appellees construction of Section 14.1 turns an obligation into a nulllity.

If there is an ambiguity in Section 14.1 — and plaintiffs cannot find any — that provision should be construed against WPPSS because the "State's self-interest is at stake." *United States Trust Co. v New Jersey*, 431 U.S. 1, 26 (1977). In rejecting an earlier attempt of Washington State to impair WPPSS bond contracts, the court in *Continental Illinois National Bank and Trust Co. v. State*

of Washington, 696 F.2d 692, 701 (9th Cir. 1983), *appeal denied for want of standing*, 460 U.S. 1077 (1983), held: "WPPSS is itself a political subdivision of the State [of Washington], made up of other political subdivisions. . . Because the State is a contracting party, we give less deference to its claims of justification for impairment." *See also Hoffer v. State of Washington*, 110 Wash.2d 415, 755 P.2d 781,786 (1988) (holding that the involvement of the Washington State Auditor in the offer and sale of WPPSS 4/5 bonds was the equivalent of the State itself engaging "in proprietary acts" making it subject to the Washington Blue Sky Laws).

The Ellenburg appellees also contend that passage of the Scienter Amendment was a legitimate exercise of Washington State authority under the police power doctrine. Ellenburg Br. at 20-22. Because plaintiffs have already thoroughly addressed this argument, Plaintiffs' Jurisdictional Statement at 17-18, we need not repeat it at length here. The fact remains appellees simply cannot demonstrate passage of the Scienter Amendment was made necessary by an important general social problem. And they made no attempt to do so in their briefs. Indeed, the circumstances of this case illustrate the prescient concern of the Framers that state legislators would be exposed to "sudden and strong passions," *Fletcher v. Peck*, 6 Cranch 87, 138 (1809), the very reason for including the Contracts Clause in the Constitution. *See* Plaintiffs' Jurisdictional Statement at 12, n. 7.

The primary case cited by the Ellenburg appellees to support their contention that the constitutional issues raised by this appeal are not substantial supports plaintiffs' position when closely examined. The appellant in *Waggoner v. Flack*, 188 U.S. 595 (1903), had violated his contract with the State of Texas to purchase land. The purchase had been made pursuant to a statute which was subsequently amended to allow for the remedy of forfeiture. Far from the interpretation given it by the appellees through the use of an out-of-context quote, the holding in that case was actually as follows: "[T]here was no promise or contract expressed in the statute that the State could not enlarge the remedy or grant another *on account of the purchaser's violation of his contract*. . ." 188 U.S. at 603. (emphasis added.) *Waggoner* thus stands for the proposition that

the Contracts Clause cannot be manipulated to shield from liability those who breach their contractual obligations. Plaintiffs seek nothing more than the same sound result on this appeal.

CONCLUSION

For the reasons above stated, this Court should deny appellees' motions and award the relief requested at the conclusion of plaintiffs' jurisdictional statement or, pursuant to Rule 16.7, such other and further relief as would be appropriate.

Respectfully submitted,

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